protean FUNDS

February 1, 2024

Disclaimer: Before considering an investment in any of Protean's funds, please refer to our prospectus and KIID-material. Investments in a fund can both increase and decrease in value. Full return of capital is not guaranteed.

January Partner Letter

Big on Small

Our big idea is small...
Small is better. Both fund size and equities. We love small caps and close our funds early.

... and the Nordics rule.
There is a Nordic structural advantage in equity small-cap opportunities. We focus solely on Nordics.

We promise to optimize for performance...
Not buzz-word marketing or asset gathering.

... and to always eat our own cooking.
We are fully invested in our funds.

Protean's story
We started Protean to manage our assets optimally, not to get rich off management fees. We believe a small fund, focused solely on the Nordics, with aligned, experienced, and well-connected managers, can generate competitive returns.

So far so good
Our first two years show great risk-adjusted returns in the hedged strategy, and – albeit with a shorter track – our long-only product has outperformed the local benchmark by a wide margin.

Protean Select, our hedge fund**,** manages 120m USD. It has returned 14.7% in 21 months, with low volatility. Most assets are from professional investors. It will close at USD 200m.

Protean Small Cap, our new long-only fund, manages USD 22m. It has outperformed the benchmark by 8.7% since its launch 8 months ago. It will close at USD 400m.

Team Protean Funds

What happened in January

The attention grabber in January is a distinct sense of increased dispersion. Cross-asset and intra-asset class correlations feel broken down, and stock picking appears to be making a massive comeback. Looking at prime broker data, hedge funds are positioned for it (which, typically, suggests it's about to reverse?) with gross market exposures both long and short within touching distance of a 5-year high.

Twitter, oh sorry, "X", is awash with various infographics and pundits pointing out that money-market funds are seeing accelerating outflows. Depleting savings to fill up empty pockets, or yield compression triggering an asset allocation shift into more growthy common stocks? Notable is also a first round of half-serious inflows to the most hated asset class on earth: Chinese stocks. According to GS, long-only China equity funds saw 12bn USD of weekly inflows in January, the largest in a decade.
Nothing beats greed. And when the Chinese equities trade on a lower price/earnings multiple than the Nasdaq's price/book multiple (!) one can be forgiven for taking a punt.

On our home turf, Scandi-land, it was a tale of two halves, with an early drop followed by a late pop, leaving indices mostly in the red for the month. There is a consensus that rates are coming down in 2024, and inflation prints plus unemployment figures appear to, so far, continue to follow the goldilocks-script that felt very alien only a few months ago (during October lows).

We have been watching markets since the mid-1990's (we're old, sue us) and seen the odd up and down. One of the trickiest things is this: changing mindset. After a long period of heightened uncertainty and down markets, it is incredibly easy to get stuck. You cling to lagging data that shows your **BEAR CASE IS STILL ALIVE AND WELL** and **WHY ARE MARKETS GOING UP, IS EVERYONE AN IDIOT?!** What is easy to forget is we are a discounting mechanism. It is often the rate of change, or the second derivative, that matters more for equities, than real time data.

You never know what's priced in, which is part of the charm, but I think I know this: for all the hullaballoo around rates, it won't matter exactly how many rate cuts get done, or by what magnitude or when. Earnings and growth are more important now. Dispersion tells us this.

We wonder if we are not in exactly one of those periods now. "*Oh no, the rate cuts will happen a few months later than we thought! Sell!*". Isn't that last year's play book? It will be an interesting year ahead for sure.

If we can wish for something, it would be a continuation of this trend. Less macro markets. That would be an ideal world for us, as exemplified in January with positive performance in the hedge fund Protean Select, and a solid outperformance vs benchmark in Protean Small cap, which was up almost 2% despite the local indices being down for the month.

The Nordic Investment Opportunity

The Nordic Investment Opportunity

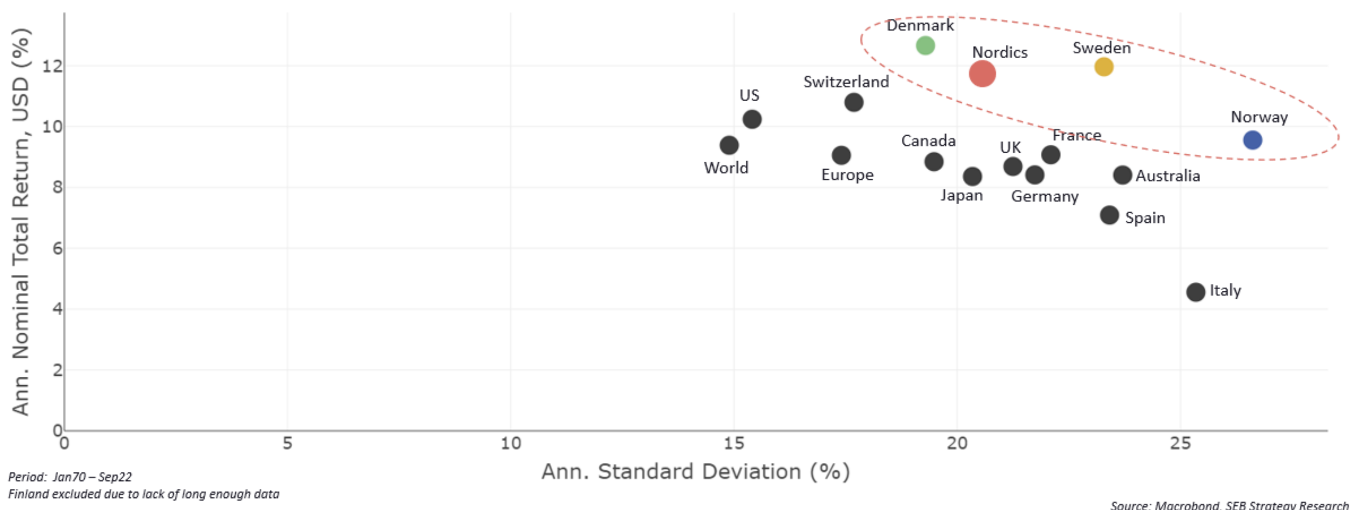
Throughout history, the Nordic countries, have posted robust economic performance. The economies are stable and diversified, with consistent growth rates. The macro fundamentals are benign, with positive current accounts, balanced budgets, and low government yields.

And if that wasn't enough: now we're all part of NATO too (almost)! The risk premia addition that followed our malign red neighbour's latest aggressions should reverse in the quarters ahead, luring international bargain hunters back into the Nordic markets.

We are renowned for innovation and technological advancement. A strong tradition of research and development and a culture of entrepreneurship, combine to create numerous successful start-ups and tech companies.

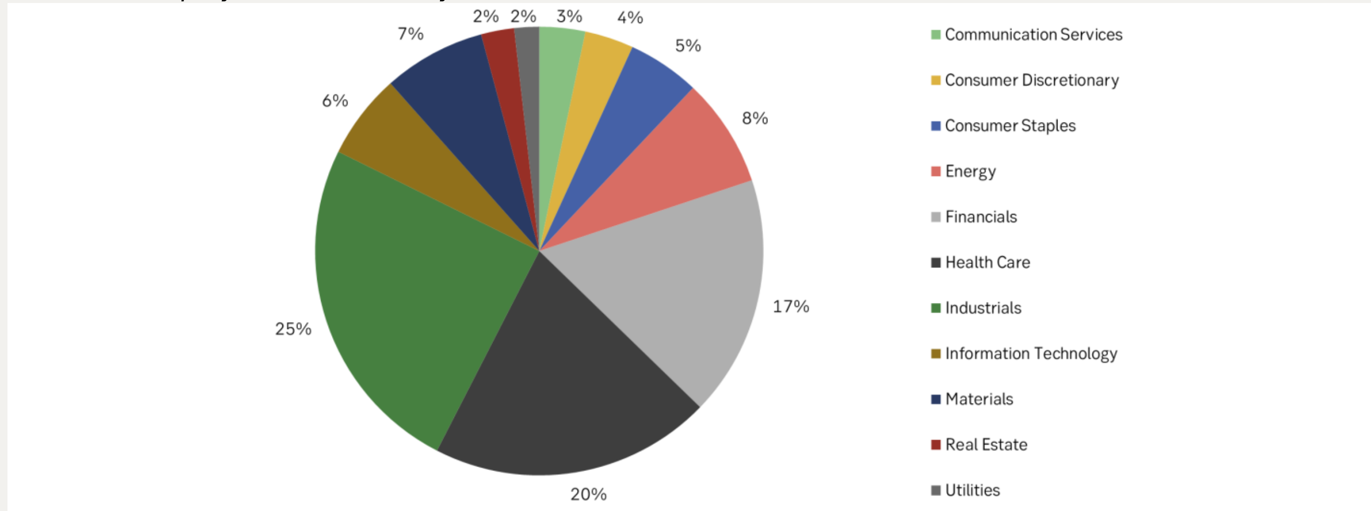
Bla bla bla, this all sounds like marketing spiel. It IS a marketing spiel. BUT – it is also facts. Just because it sounds like platitudes does not make it less important or untrue.
The data speaks for itself: over long periods of time the Nordics rule.

Although locals sometimes do not share the sentiment, there is a long-standing tradition of political stability, with well-established democratic systems and strong institutions. This yields a predictable and secure environment for businesses to operate in. Add a globally competitive educational system, based on egalitarian principles, and you have a deep pool of skilled workers and entrepreneurs.
No wonder Nordic equities have delivered outstanding positive returns in the past 50+ years:

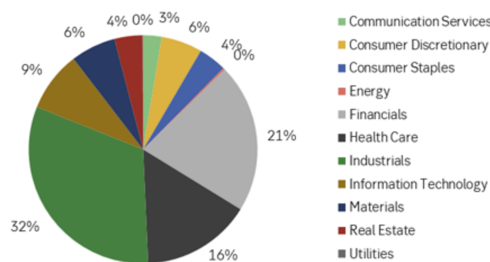


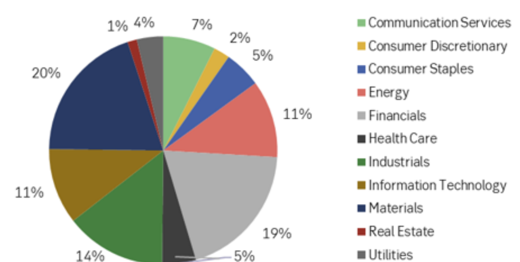
Our local capital markets are large and diversified, with a total market cap exceeding EUR 2tn. The investing public is more active and knowledgeable compared to most regions of the world. This has created a particularly vibrant small- and microcap market, where companies can seek listing and equity financing in unusual numbers and unusually early in a corporate life cycle.

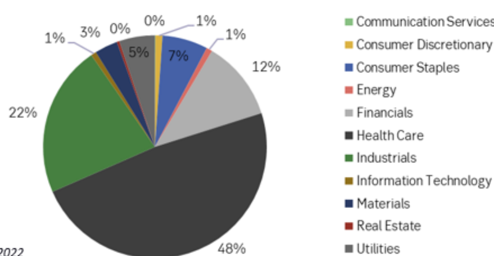
The Nordic Equity Market sliced by sector

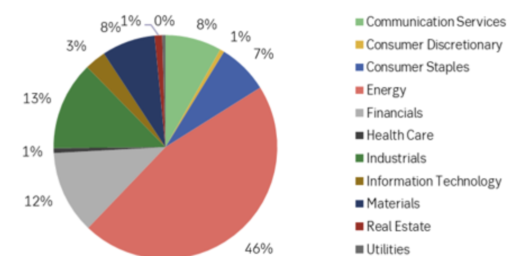


Each country has its own focus, but taken together it's well diversified









The flip side of common men investing in common stocks is that delusions too tend to become common. In recent years there are plenty of examples of retail hysteria. This creates amazing shorting opportunities. We also have a handful of tightly controlled family groups allowing big businesses to fall by the wayside from both ignorance, negligence and sometimes just leverage. No wonder we have seen a few high-profile short cases in recent years (SBB comes to mind, as does FING, or HTRO for that matter).

But mostly the environment is benign. A study by capital manager Alta Fox (**"The Makings of a Multibagger"**) found that Sweden, Norway and Denmark were significantly overrepresented domiciles for high-performing small- and mid-cap equities. We are not surprised. With certain restrictions, the Nordic countries were 13% of the investable universe in the study but accounted for no less than 25% of the top performers. As a comparison, the US was 44% of the sample, but only accounted for 29% of the top performers.

Even though the markets are large and diversified, the number of companies trading is small enough that a small, experienced team can keep tabs on development. When you (like us) have spent every waking hour for the past 20 years meeting companies, reading reports and research, travelled the globe to see facilities, competitors, and customers, you build a knowledge base that lowers the hurdle for investing. It is exceedingly rare for team Protean to stumble across a Nordic-listed company where we do not have at least a reasonable idea of what they do and who they are. Most likely, already as a starting point, we have a feel for the directors, the key investors, the management, and the relevant sell-side research analysts.

The above underlines another key attraction: avoid crowding. A smaller fund, with a regional niche approach, can choose the road less travelled by pod-shops and pan-European hedge funds. On occasions we find ourselves in a crowded trade, our size restriction and diversified portfolio, plus access to all local liquidity pools, significantly mitigates squeeze risk.

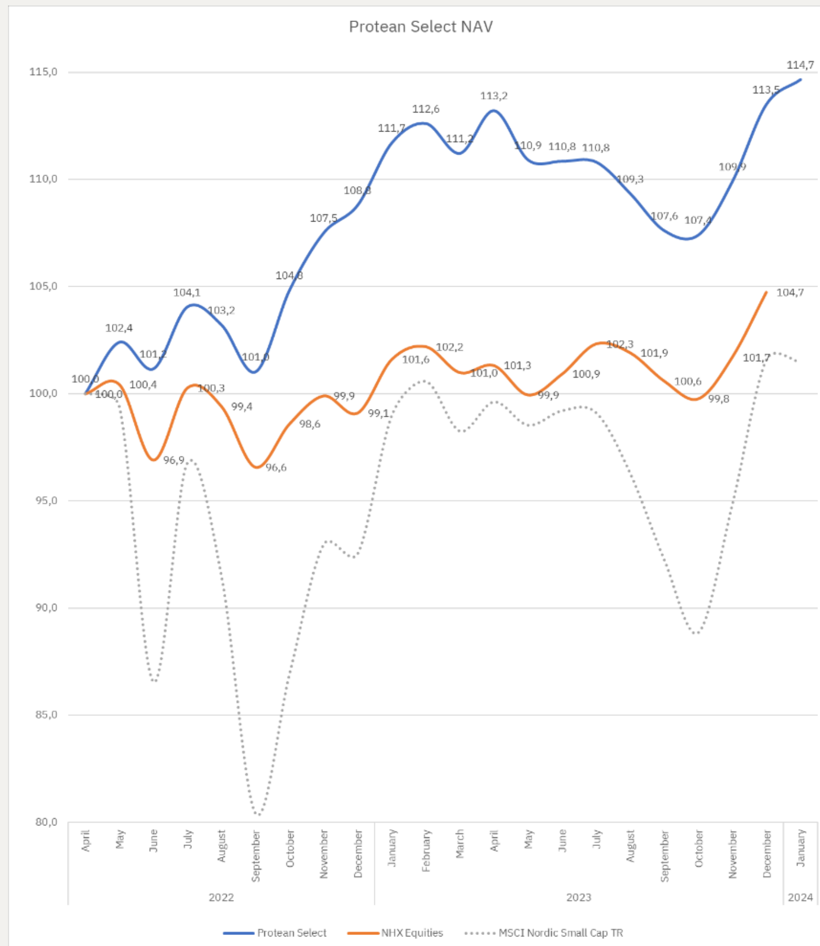
The edge in being a local investor, physically present in your local market, is the network effect that comes into play when you are deeply rooted in an investment ecosystem. We believe being local is essential to managing cultural differences in communication, building rapport with key stakeholders, and enhancing idea generation. As half of investing is psychology, it is also crucial to know the narrative and where in a story cycle a particular stock resides. The grapevine is an often-underestimated asset.

To conclude...

We believe we have a set-up and products well suited to thoughtful international investors looking for exposure to the Nordics. Investors that want to form a long-term partnership with a local experienced fund that optimizes for performance, not asset gathering.

Get in touch.

Protean Select – update for January



**We illustrate our performance by showing a comparison with the NHX Equities index. This is an index constructed from the performance of 54 Nordic hedge funds focusing on equity strategies. NHX is published after our Partner Letter, so updates with one-month lag in the chart above. We aim to have positive returns regardless of the market, but no return is created in a vacuum, and a net-long strategy will correlate. Our hurdle rate is >8% annualized (4% + 90-day Swedish T-bills). All figures are net of fees.*

Returning 1% in slightly contracting markets is a one-month result we're ok with. If we can do something similar every month, for a few years, things will be alright. In 21 months, since inception, the fund is up 14.7%. As mentioned earlier in the letter, there was elevated dispersion in January. Which also shows up in the shape of our returns.

Avid readers will remember we have had a cautious attitude to the Nordic banks. *We have changed our minds.* Fading tailwinds from the net interest income-line appears to follow a more manageable glide path than we earlier assumed, and the capital distribution potential paired with appealing valuations and a thawing real estate credit market made us revisit our thesis. We gently backed out of our short positions in the sector without suffering too badly.

We have held **Byggfakta** since the fund's creation and written at length in an earlier letter about how it was misunderstood and mispriced. In January its main owners saw fit to attempt to buy out the company, with a modest 30% premium, making it our best contributor to returns for the month.

Our second-best performer was Swedish defence stock **SAAB**, followed by a **basket of small cap shorts** and a long position in **SOBI**.

On the negative side was our **short position in EUR/SEK** (entirely offset by FX gains in our non-SEK holdings) followed by a, arguably, too early entry into **Embracer**. We think there are signs of healing in the gaming space, as studios close down across the globe. We might be one or two quarters early here, but there is value in a few names.

Our third biggest loser for the month was long-time holding **Alleima**, which retracted on its earnings announcement, as analysts was too optimistic going into the print. We are not concerned with the quarterly volatility and remain long-term owners.

Ramil’s corner: new additions to the portfolio

Avanza and **Nordnet** are online retail savings-focused banks. Locals love ‘em for their long growth runway, capital light business model, and extreme returns on equity. This explains rather aggressive valuations. However, to international investors, the appeal seems more elusive: intensifying competition, restricted addressable markets, and plausible arguments as to why revenues and profits are, at best, plateauing, make it difficult to share the locals’ enthusiasm.

Here's our take. While Nordnet significantly trailed Avanza prior to its takeout in 2016 - **ROE differed a staggering >20pp in 2015** - things have turned around completely after a period of Nordnet investing heavyily in IT during its unlisted phase.

Presently, Nordnet addresses a TAM that is 3x as big (all Nordic countries, as opposed to Avanza only present in Sweden); it has built a more advanced tech stack (evidenced by less downtime); and, perhaps most importantly (but unquantifiable) – has a culture that seemingly is an order of magnitude times more forward-leaning.

It’s remarkable Nordnet is trading at a 10% discount to Avanza despite a close to 10% higher ROE.

However, we do see the non-negligible risk of diminishing profits. A conceivable scenario involves a reduction in interest revenues, and commission revenues grow at insufficient clips to help offset while OpEx growth sits at 10% in both (acknowledging that Nordnet’s OpEx growth seems to be more offensive-oriented than Avanza’s). Throw the recent announcement of “Montrose by Carnegie” about to launch into the mix: if its business plan had the title “how to eat Avanza’s breakfast and lunch” we would not be surprised. Montrose is targeting the semi-rich and online-savvy Swedish customer group, with a team that so far largely consists of ex-Avanza employees. All the while Avanza is struggling with management turnover and half-baked communication (do listen to the Q4 conf call).

So, while we have a preferred long, we are cautious about assuming the NII-risk associated with interest rate movements. Simultaneously, we have a preferred short but are wary of said risk on the upside too. Sounds like a very reasonable market neutral pair trade to us.

Hafnia – greasy but good

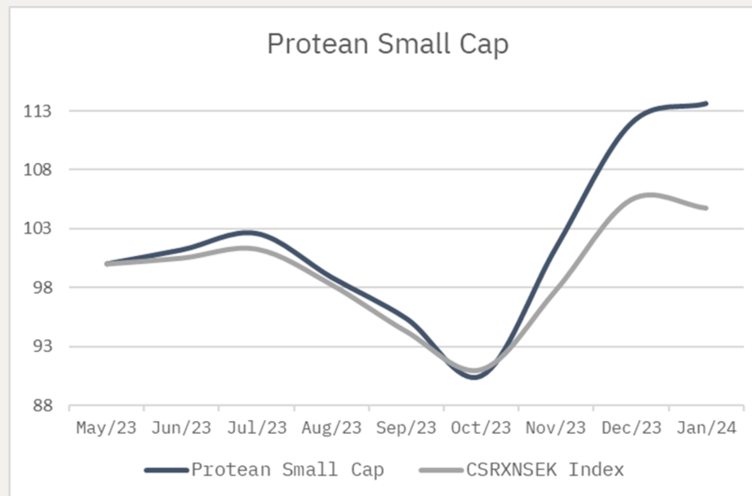
The general maxim in shipping stocks is to sell when it looks the cheapest and buy when it looks the most expensive. Demand is cyclical, supply is fixed, and assets are fixed and heavy. Incremental demand gives a disproportionate impact on rates and vice versa. It should therefore come as a surprise to readers of this word salad that we say we are long Hafnia at sub-5x PER, >25% FCF yield and 0.9x P/NAV. The reason is spelled geopolitics. The war in Ukraine shut out Russian petroleum products from the global market and in addition also rendered Russia and its trading partners in need of a fleet. This happened on the back of very weak markets in 2021 which led to a vacuum in new vessel orders. Thus, supply of refined oil came down while demand for product tanker vessels came up – driving up second hand prices (oftentimes for end-of-life vessels). But when rates started spiking, shipowners realised that shipyards were fully booked. Add it all together and couple it with a well-timed M&A by Hafnia, EBITDA grew by a factor 7x 2021 into 2022 and enabled the company to reduce LTV from close to 60% to sub-30% as of Q323 – thus also triggering payout ratio-hikes, enabling a healthy double digits DPS yield.

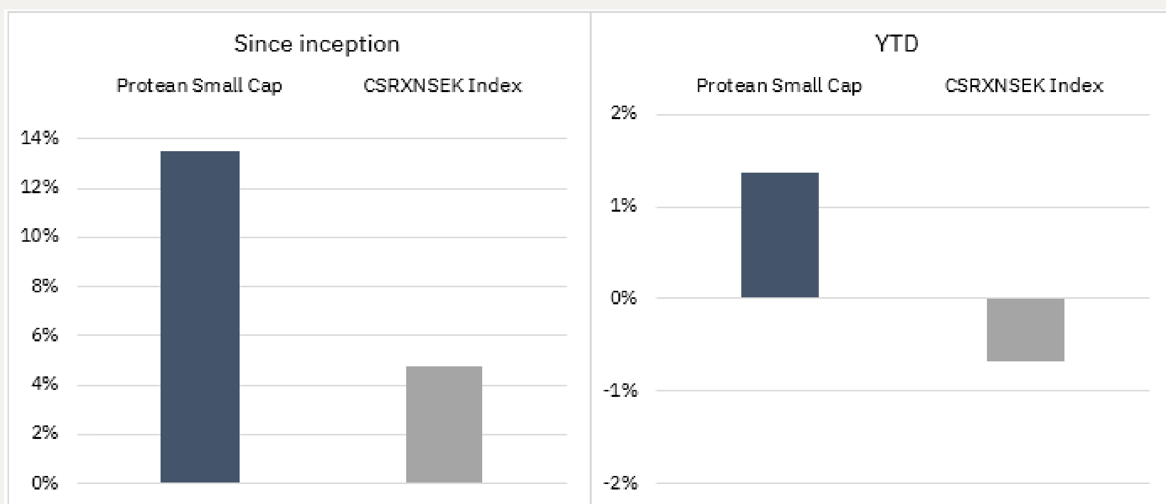
So far, so good. But why is Hafnia a case *today*? We argue the Red Sea-situation poses an optionality on even higher estimates ahead. Spot rates have indeed spiked, but the few analysts who have pencilled this in refrain from extrapolating it further out than Q1. With an aging product tanker-fleet, low deliveries in the years to come, two unfortunate wars with no apparent resolution in sight, you end up in a situation where Hafnia remain (yes, remain, and not become, because look at how the share has traded since early-2022) a higher-for-longer-case. We remain humble to the fact that it's virtually impossible to forecast whether (when?) geopolitical turbulence will get resolved, and as is the case with any other case mentioned here, we try to be nimble and mindful of any datapoint that could alter the case.

February 1, 2024

Protean Small Cap – Carl's update for January

January was a strong month for Protean Small Cap. We close the month at +1.4%, meaning that performance since inception in June lands at +13.4%. In doing so we closed 2.0% ahead of our CSXRN (SEK) benchmark for the month, and 8.7% ahead since start.





Byggfakta became the strongest contributor in January as a consortium of the current PE owners and Macquire offered to pay a 31% premium. The biggest problem with Byggfakta's tenure as a listed company has been its failure to attract sufficient interest in their narrative: at face value, it looks like a play on the Nordic construction market, which obviously has worked against them. Looking closer, you'll see a very cash generative business which managed to grow 6% organically in their most recent quarter while also expanding margins. It's always bittersweet to get a bid on a holding – the immediate price action obviously is helpful, but you (presumably) also lose out on future value creation.

We were also helped by **Dustin** which performed strongly post the finalization of their rights issue as well as a quarterly report that had some (but not many) green shoots. **Devyser** announced a couple of meaningful business wins, especially an agreement that will help improve the utilization of the recently

constructed US laboratory. The investment case holds a number of optionalities that could fuel momentum in 2024.

Detractors include **Kambi**, **Embracer** and **Alleima.**

We've added **Rejlers** and **Vaisala**.

Rejlers is a Swedish technical consult with Nordic operations. After a period of lacklustre performance, Rejlers has improved vastly during the current CEO Viktor Svensson. The share has struggled recently, as concerns about their exposure to building in Sweden and Finland has been in focus – for good reasons, it looks pretty awful near-term. However, we set our eyes on the bigger price: the upgrade of the Nordic power generation system as well as the Nordic grid. This is a huge investment cycle, underlined by recent announcements from grid operators such as Statkraft. The share trades at sub-10x EBITA for 2024E, which we consider to be as good of an entry opportunity as one might get in a quality business with multi-year growth opportunities in their existing areas.

Vaisala is a Finnish measurement company, partly weather related, partly industrial. It's a quality company that we have had on the radar for a few years, but we have never really sensed the opportunity prior to now. That being said: timing is difficult. With roots in weather measurement (which is exactly what it sounds like) they have gradually moved into industrial measurement for processes where things such as humidity are of importance. These include battery manufacturing plants and data centres, as well as life sciences. Long-term growth areas that suffer from a post-pandemic slowdown. We think that this is temporary but could remain weak for a few more quarters. While the market focus has been on the weaker orders, especially from life science, we believe that profitability can come to surprise positively on cost (less component purchases on spot).

protean FUNDS

February 1, 2024

The monthly reminder

We optimise for performance, not for convenience, size, or marketing.
You can withdraw money only quarterly (monthly in Small Cap).
We will tell you very little about our holdings.
Our strategy is tricky to describe as we aim to be versatile.
A hedge fund can lose money even if markets are up.
We charge a performance fee if we do well.
You do not get a discount if you have a larger sum to invest.
We do not have a long track record.

Thank you for being an investor.

Pontus Dackmo
CEO & Investment Manager
Protean Funds Scandinavia AB